

THE IMPACT OF THE PROVINCIAL SALES TAX ON NEW HOUSING CONSTRUCTION IN SASKATCHEWAN



Regina & Region
Home Builders'
Association



Saskatoon & Region
Home Builders'
Association



NOVEMBER 2019

A CALL TO ACTION IN SUPPORT OF SASKATCHEWAN'S NEW HOME BUILDING INDUSTRY

Despite signs of economic recovery in Saskatchewan, 2019 will be characterized by low housing starts and low valued building permits. Investment and employment in the new housing sector are expected to be at a decade low.

This slow year for housing starts stems from two major factors. First, stricter rules to qualify for a mortgage due to the implementation of the national mortgage "stress test." Second, the impact of changes to Saskatchewan's Provincial Sales Tax (PST) made in April 2017, which increased the tax rate on new housing construction by 2.62%.

Due to changes to the PST, potential homebuyers in Regina and Saskatoon required a 5% increase in down payment to maintain the same purchasing power. In response to the PST changes, median household incomes needed to rise 25% in Regina and 29.5% in Saskatoon in order to purchase the same \$400,000 pre-tax home compared to September 2016. The residential construction industry is operating below efficiency, which translates into suboptimal revenue collection for the provincial government.

In order to take immediate action to revive Saskatchewan's stagnant new housing market, the Province must consider ways to mitigate the impact of the PST on housing construction.

This report provides an analysis of three potential rebate structures that the Provincial Government could implement. The rebates would improve the affordability and accessibility of housing in Saskatchewan as well as stimulate additional housing demand. Although there may be an initial cost borne by the Province in terms of forgone tax revenue, the data presented in this report suggests that upfront costs associated with a rebate on the PST of new home sales would be more than offset by the additional economic activity it would stimulate. A 5% increase in housing starts alone would result in an additional \$29.5 million in GDP growth, 265 jobs, and more than \$15.3 million in income for Saskatchewan families.

Each of the rebates presented in this report is intended to stimulate the housing market and support companies in the residential construction sector. This will give companies the ability to re-invest profits, maintain jobs and support overall economic growth throughout our province.

EXECUTIVE SUMMARY



2019 is on track to be one of the **slowest** years for new home construction in Saskatchewan.



Housing construction will be **well below the 20-year average in 2020**, despite a modest uptick in construction.



Investment and employment in new housing construction are expected to be at a **decade low**.



Net **PST** payments **increased 218%** in Regina and **203%** in Saskatoon between 2016 and 2019.



The day after the **PST changes were implemented**, homebuyers required **3.8% additional income in Regina and Saskatoon** to purchase the same \$400,000 pre-tax home compared to the previous day.



Median household incomes must rise 25% in Regina and 29.5% in Saskatoon to purchase the same \$400,000 pre-tax home compared to September 2016.



Rebates on the PST of new home sales will **improve the overall affordability and accessibility** of housing and will stimulate additional demand.



The cost of a rebate structure would be more than offset by additional economic activity. A 5% increase in housing starts represents an additional \$29.5 million in GDP, over 265 jobs and over \$15.3 million in income for Saskatchewan families.

CANADIAN HOUSING OVERVIEW

Over the past three years, home prices in the Greater Toronto and Greater Vancouver areas have risen substantially, driven by strong demand and limited supply. Price increases have forced some borrowers to take on high levels of debt, subsequently pushing Canadian household liabilities to an all time high.

Meanwhile, as interest rates continue to be at historical lows, the Office of the Superintendent of Financial Institutions (OSFI) has implemented new regulations to ensure that borrowers only take on mortgages they can afford. OSFI rules require buyers, despite their down payment amount, to undertake a mortgage "stress test". This is to determine if borrowers would be able to pay back their loan if interest rates were to increase.

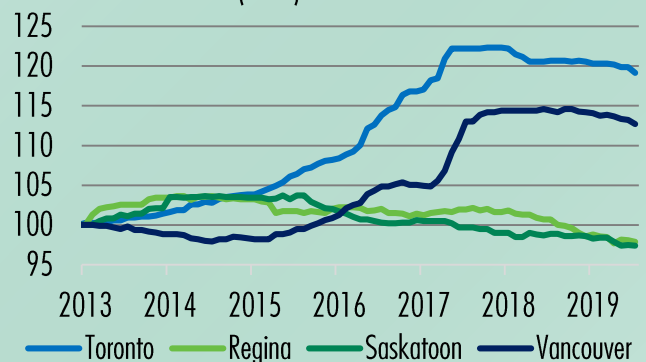
The new mortgage rules are intended to cool down prices in the Vancouver and Toronto housing markets. However, households with no equity, mainly first-time buyers and markets without rising costs concerns, such as Regina and Saskatoon, were disproportionately affected by the measures.

Table 1– Household financial position (%)

Multiple	Canada	Saskatchewan
Mortgage liabilities / assets	11.1%	8.3%
Debt / disposable income	183.0%	154.4%

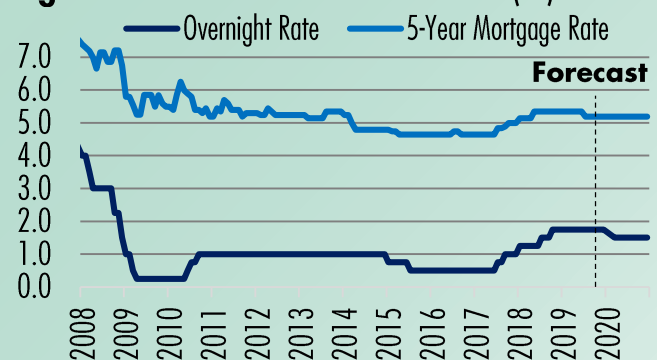
Source: Statistics Canada

Figure 1 - Historical cost of home ownership
Index – Dec 2012 (100)



Source: Statistics Canada




Figure 2 - Historical interest rates (%)



Source: Statistics Canada, Conference Board of Canada & BCREA

SASKATCHEWAN MAIN ECONOMIC INDICATORS

Table 2 – Economic indicators

		Historic 10-Year average	Forecast 3-year Average
 Population Growth	Regina	2.03%	1.77%
	Saskatoon	2.26%	1.94%
 GDP Growth	Regina	2.95%	1.80%
	Saskatoon	3.26%	1.16%
 Employment	Regina	2.09%	1.91%
	Saskatoon	2.13%	1.48%

Saskatoon CMA

	2017	2018	2019F
Real GDP Growth	2.59%	1.06%	-0.15%
Population growth	2.69%	2.21%	1.84%
Unemployment Rate	7.90%	6.63%	5.97%
Personal Income Per Capita (\$)	\$49,991	\$50,689	\$51,794
Retail Sales (\$ Millions)	\$7,567	\$7,694	\$7,848
Inflation	1.35	1.38	1.41
Housing Completions, Total	2,053	1,568	1,665

Regina CMA

	2017	2018	2019
Real GDP Growth	1.91%	1.48%	1.60%
Population Growth	2.59%	2.28%	1.79%
Unemployment Rate	5.05%	5.93%	4.88%
Personal Income Per Capita (\$)	\$51,866	\$52,224	\$53,833
Retail Sales (\$ Millions)	\$5,765	\$5,826	\$5,944
CPI (Annual Changes)	1.35	1.38	1.41
Housing Completions, Total	1,580	2,050	1,297

Source: Statistics Canada & Conference Board of Canada

In the early 2010s, Saskatoon and Regina were leaders in terms of economic, population and employment growth. Saskatchewan has an abundance of natural resources. Additionally, the province is renowned for being a leader in technological developments such as clean-coal power generation, animal vaccine research and nuclear science.

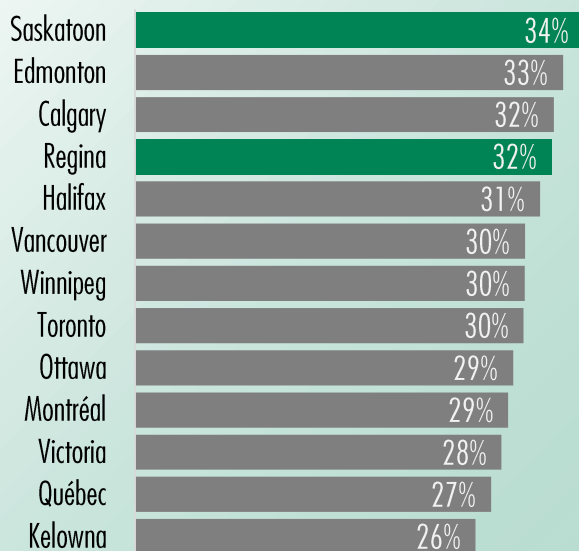
While Saskatchewan's economy appeared to be in recovery mode following the commodity bust, the economy lost steam throughout 2018 and into 2019. The turmoil from commodity prices seems behind us, but a return to a boom cycle is unlikely.

The province is slowly diversifying into value-added sectors (such as technology, business and professional services). However, commodity exports are still king in the region's economy.

While there are some green shoots in the provincial economy, growth in the region is expected to be moderate at best.

SASKATCHEWAN DEMOGRAPHICS

Figure 3 – Share of millennials



Source: Environics

Saskatchewan has a workforce that is young and well educated. Almost 60% of workers in the province have completed post-secondary education or training.

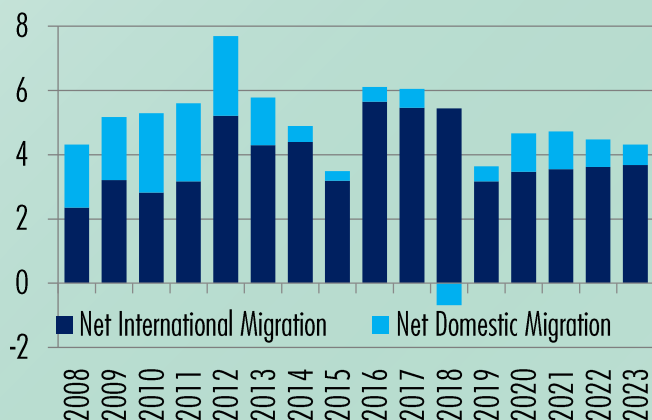
Saskatoon and Regina have some of the highest shares of millennials in Canada (ages 20 to 34).

Indigenous people made up about 15.9% of the province's population in 2016 and are expected to account for about one in five people in Saskatchewan by 2036.

International immigration has been a success story despite economic woes. Sluggish labour markets may have slowed down population growth. However, population growth for the next five years is still expected to grow well above the 20-year average.

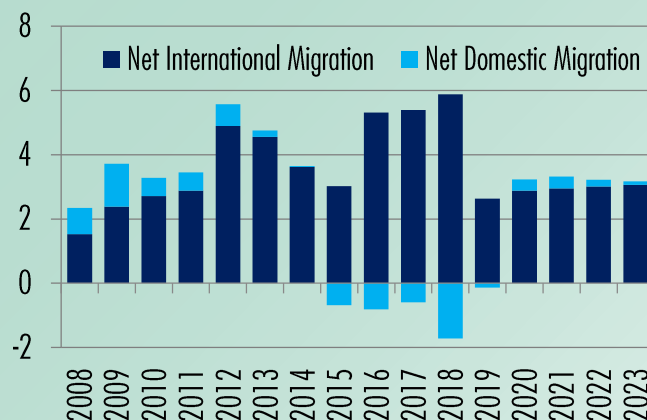
Figure 4 – Migration trends (000s)

Saskatoon CMA



Source: Statistics Canada & Conference Board of Canada

Regina CMA



SASKATCHEWAN NEW HOUSING OVERVIEW

The provinces of Ontario and British Columbia continue to experience strong population growth and economic growth. These trends are driven by thriving technology companies and solid consumer demand. This has led to robust gains in the residential construction sector since 2014. On the other hand, Saskatchewan's housing sector continues to be on life support. The residential construction industry is expected to contract yet again in 2019 following five years of flat or negative growth. Decreasing housing prices, the political turmoil surrounding pipeline construction, and global trade uncertainty continue to stifle growth in the prairie province.



New home sales are well below historical highs of 2014 with markable declines following the implementation of the stress test and the changes to the PST.

The inventory of completed but unabsorbed new homes has substantially decreased in both Regina and Saskatoon. However, the stock of unsold housing continues to be above the 20-year average for both cities.

There is no relief for home builders in the near future. The lack of demand combined with the high levels of new housing inventory has led to a substantial decrease in housing starts throughout the province. Both Saskatoon and Regina are on track for the slowest new home construction season in 17 years. Housing starts are forecasted to see a modest uptick in 2020. However, construction will remain below the 20-year average.



On a per square foot (PSF) basis prices have declined but overall average prices continue to rise as the size of the average home continues to grow.

CONSTRUCTION COSTS



Home builders gross profit declined from 11.7% in 2014 to 7.7% in 2018 according to the Regina Residential Cost of Construction 2018 Report



Despite weaker demand, land prices have remained stable in both Regina and Saskatoon.

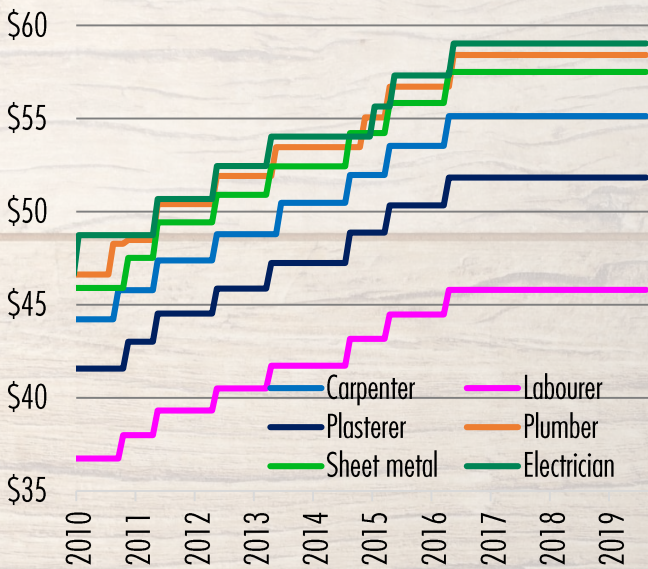


The cost of construction materials continues to rise putting additional pressure on builders.



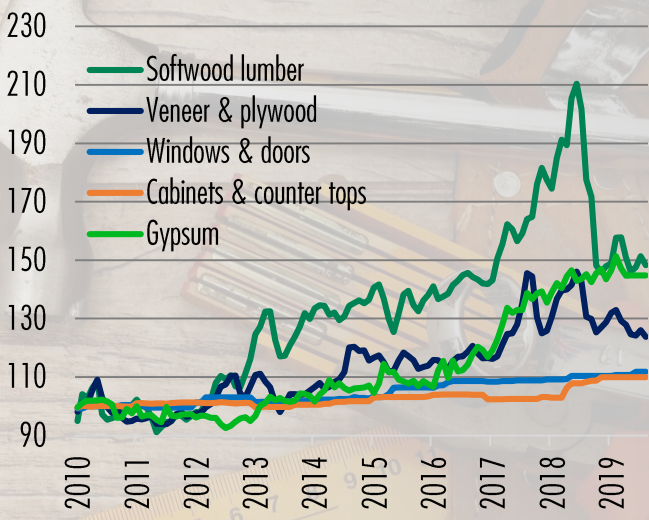
Labour costs have remained unchanged for almost 3 years.

Figure 5: Construction union wage rates



Source: Statistics Canada

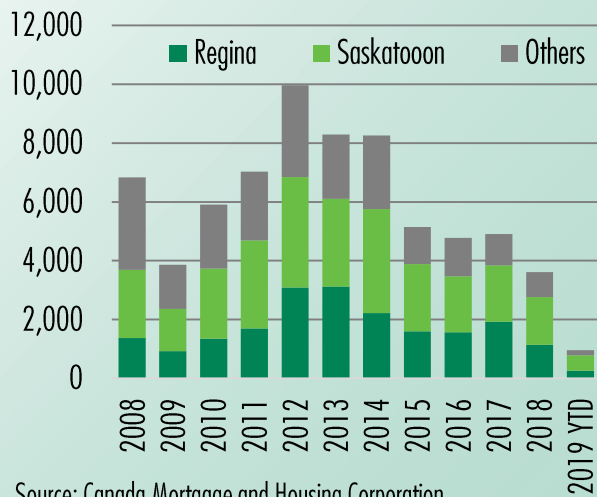
Figure 6: Industrial product price index –2010 (100)



Source: Statistics Canada

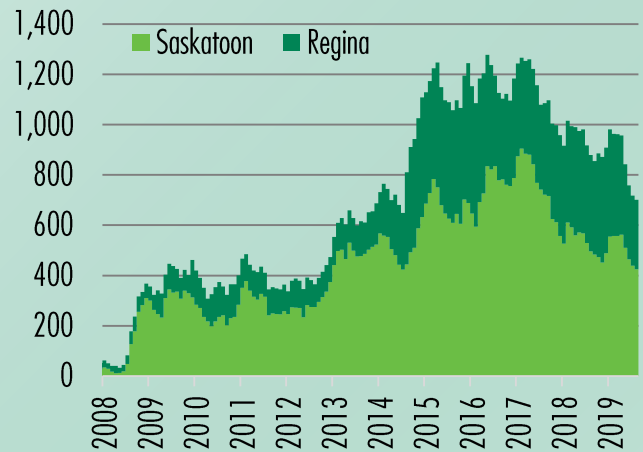


Figure 7 – Saskatchewan historical housing starts



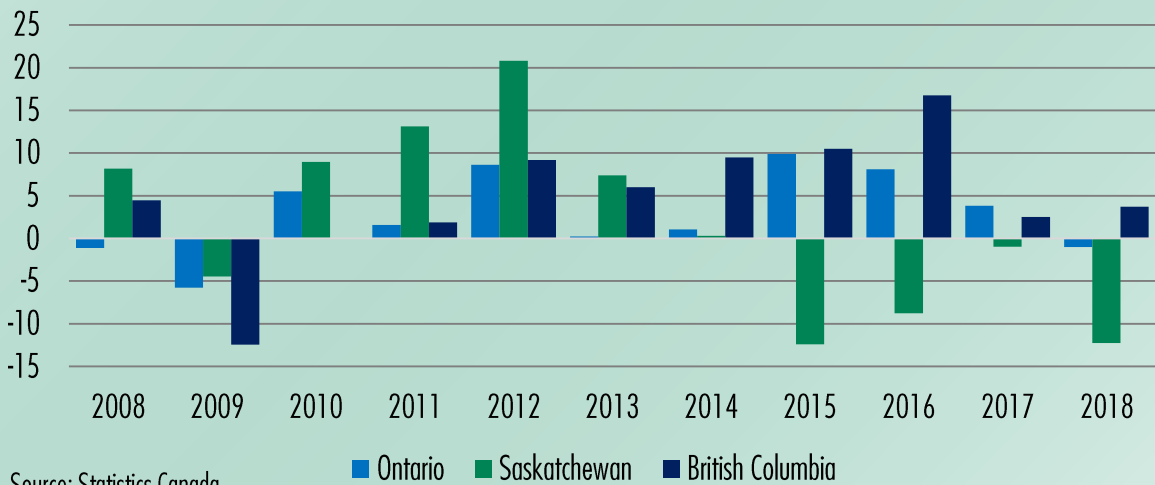
Source: Canada Mortgage and Housing Corporation

Figure 8 – Saskatchewan unabsorbed new housing



Source: Canada Mortgage and Housing Corporation

Figure 9 - Residential construction GDP growth (%)

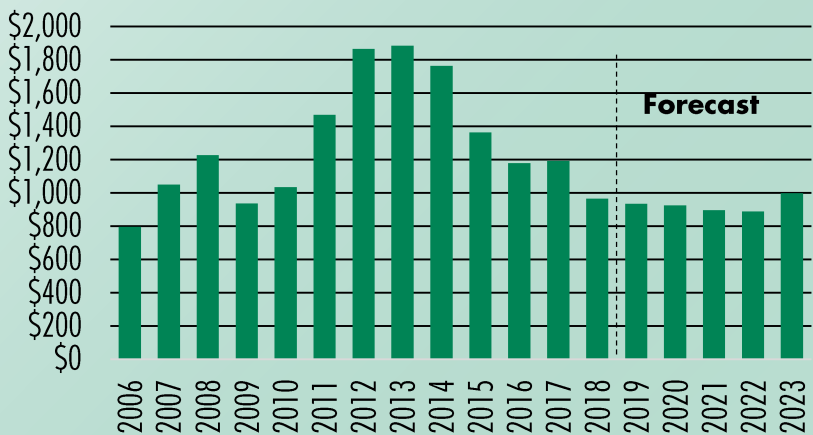


Source: Statistics Canada



Figure 10 – Saskatchewan historical new housing investment 2007 \$ Millions

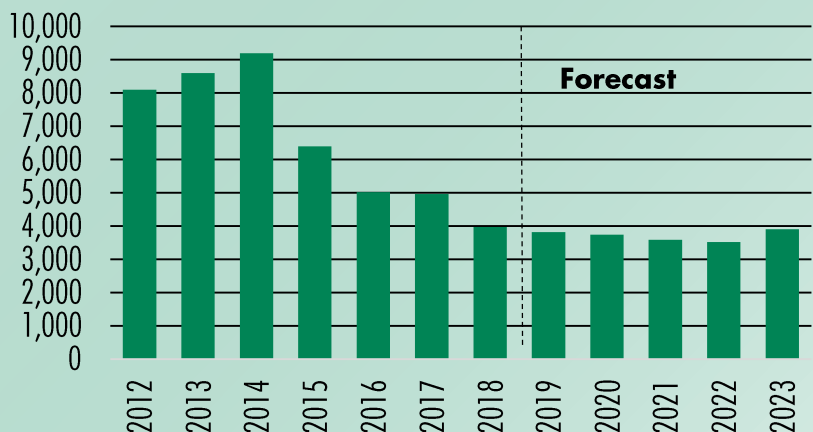
In 2019, real investment in new housing construction (adjusted for inflation) is expected to hover around the \$935 million mark. This represents a decrease of over 50% compared to the peak in 2013. Over the foreseeable future, an increase in investment is unlikely as population growth slows down in Saskatchewan.



Source: BuildForce Canada

Figure 11 – Saskatchewan new housing construction employment

The sharp decline in housing starts has resulted in over 5,000 job losses in the new housing construction sector. Employment in the construction housing industry is expected to continue to recede until 2022.



Source: Statistics Canada, BuildForce Canada & Authors own calculations

REGINA NEW HOUSING MARKET

Figure 12 – New housing price index

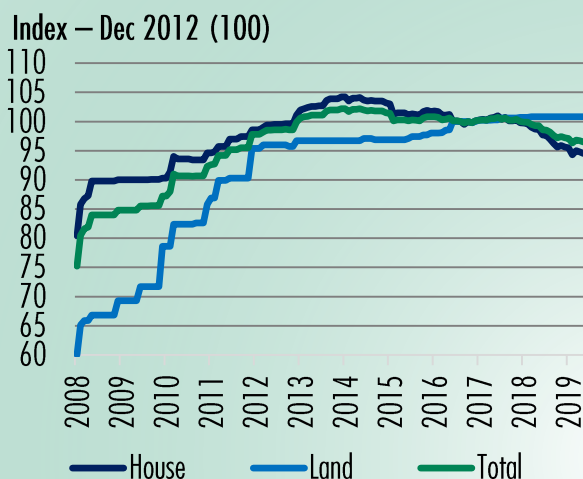


Figure 13 – Characteristics of new detached homes - City of Regina

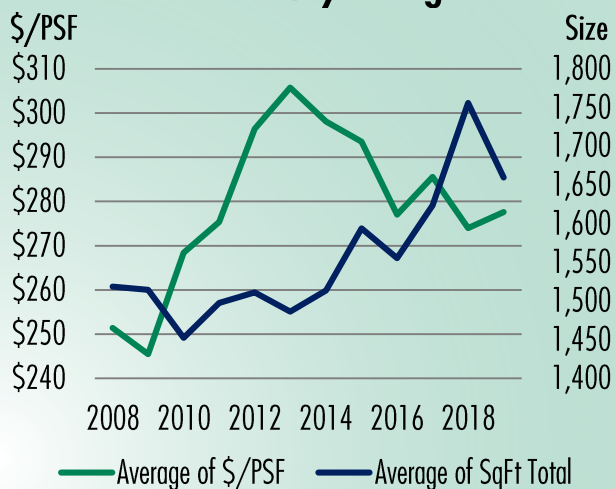
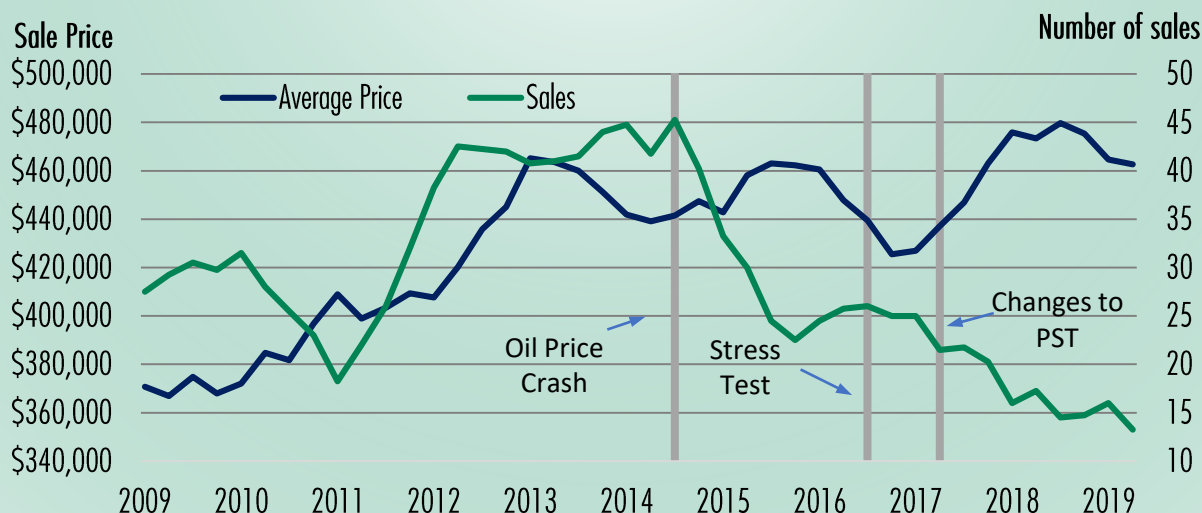


Figure 14 – New construction detached homes sales – City of Regina

4 quarter moving average



Source: Author's own calculations with data from the Association of Saskatchewan Realtors

SASKATOON NEW HOUSING MARKET

Figure 15 – New housing price index

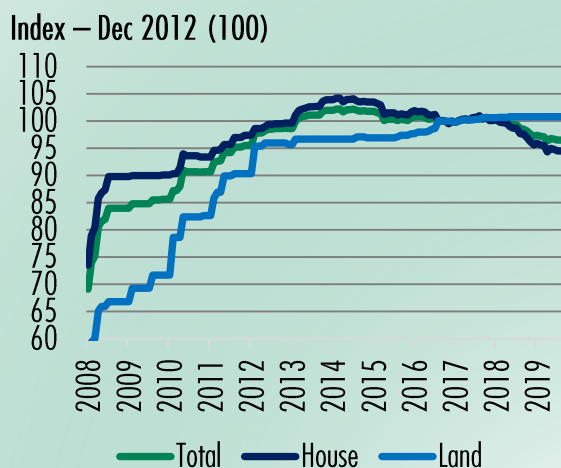


Figure 16 – Characteristics of new detached homes - City of Saskatoon

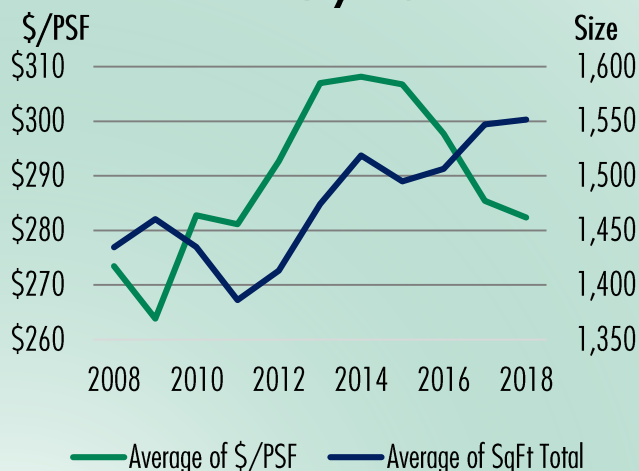
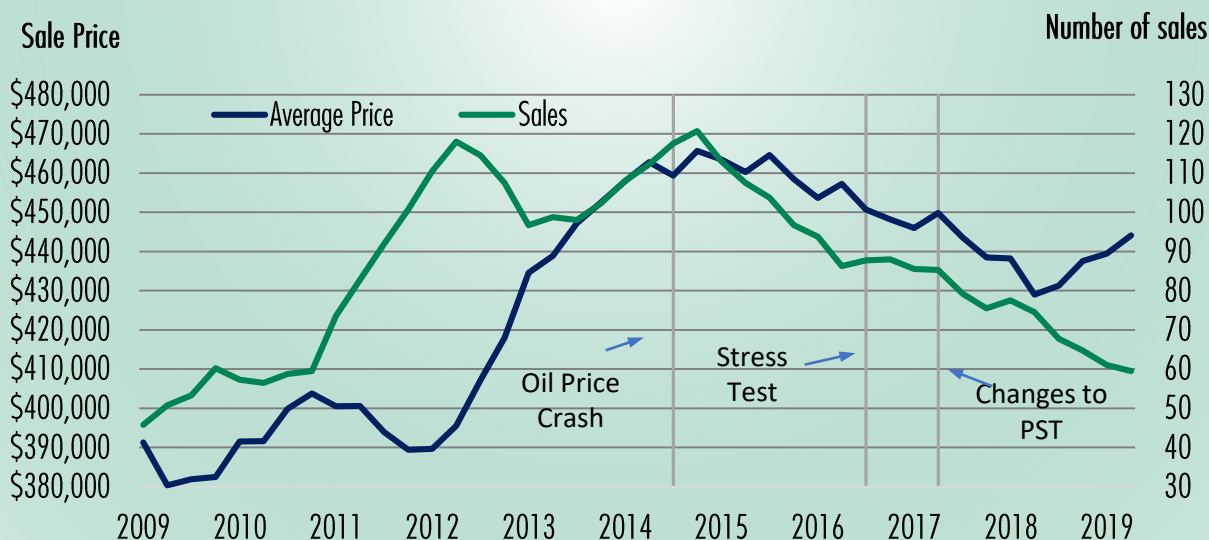


Figure 17 – New construction detached homes sales – City of Saskatoon
4 quarter moving average



Source: Author's own calculations with data from the Association of Saskatchewan Realtors

2017 SASKATCHEWAN'S REAL PROPERTY PROVINCIAL SALES TAX CHANGES

On April 1, 2017 the Government of Saskatchewan set out a number of changes to the Provincial Sales Tax (PST), including an increase in the rate (from 5% to 6%) and the removal of a number of PST exemptions. Prior to 2017, home builders paid PST on the cost of equipment or materials consumed in building projects. Builders quoted their services as "PST included" but did not collect tax from the owners of projects. Under the new rules builders can purchase materials exempt of PST but are required to collect PST on the "retail selling price" of the premises to the purchaser, excluding the value of the land.



**PST NEW
HOUSING
4.20%**



**PST
INCREASE
2.62%**

Previous Tax = PST (Materials & Services)

New Tax = PST (Retail Sale – Fair value Land)

Increase = PST (Retail Sale – Land – Materials & Services without taxes)

Table 3 - Changes in real property Provincial Sales Tax*

	Before PST increase	After PST increase
Total Cost	100.0%	100.0%
Land	30.0%	30.0%
Dwelling	70.0%	70.0%
Dwelling Cost	70.0%	70.0%
Materials (40%)	28.0%	26.4%
Labour (60%)	42.0%	43.6%
PST	$100\% \times 70\% \times 40\% / 1.06 \times 6\%$	$100\% \times 70\% \times 6\%$
PST collected	1.58%	4.20%
Net increase		2.62%

*Excludes the impact from the increase in the PST rate

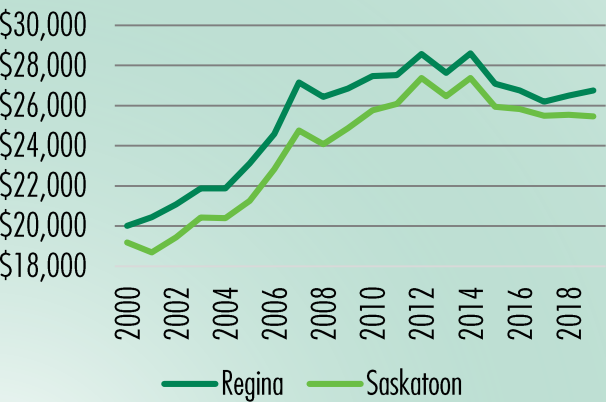


IMPACT FROM THE PST

Net taxes on home purchases continue to increase while real incomes have declined in both Regina & Saskatoon making home ownership harder, especially for new Canadians, firsttime home buyers and vulnerable groups.

On a relative basis the increased PST is constant. However, home price inflation magnifies tax payable on an absolute basis.

Figure 18 – Real disposable household income per capita



Source: Conference Board of Canada

Figure 19 – Tax burden on a new, average priced, detached home – City of Regina

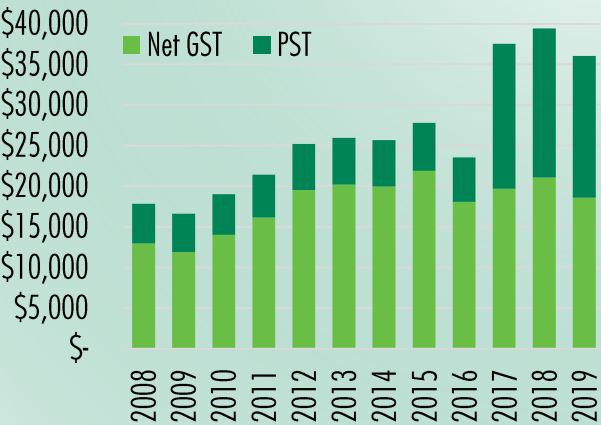
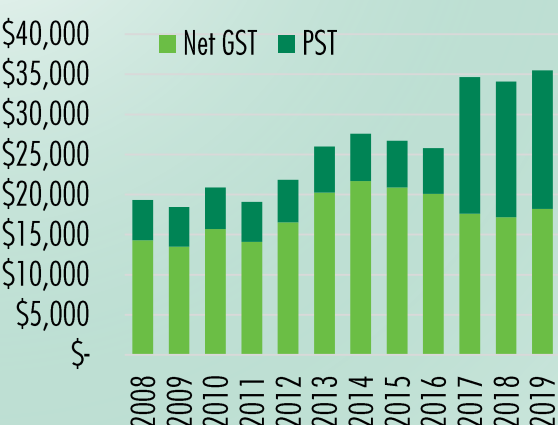


Figure 20 – Tax burden on a new, average priced, detached home – City of Saskatoon



HOUSING AFFORDABILITY

After the implementation of the stress test, homebuyers required 18.4% additional income in Regina and 19.9% in Saskatoon to purchase a \$400,000 pre-tax home.

The day after the changes to the PST, the minimum income to qualify for a mortgage to purchase the same \$400,000 pre-tax home increased 3.8% in Regina and Saskatoon compared to the previous day.

To maintain the same purchasing power compared to the day before the changes to the PST, home owners in both Regina and Saskatoon required a 5% increase in down payment.

Median household incomes must rise 25% in Regina and 29.5% in Saskatoon to purchase the same \$400,000 pre-tax home compared to September 2016.

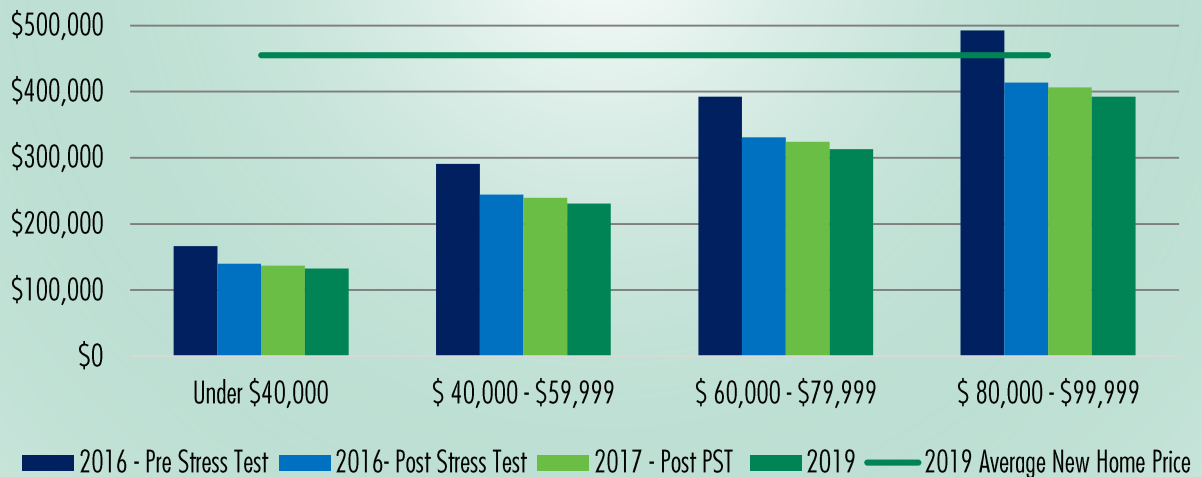
REGINA HOUSING AFFORDABILITY

Figure 21 – Impact on housing affordability as a result of policy changes

	Household income required to buy a \$400,000 pre-tax home	Maximum Post-tax home price affordability for the median household income
2016 - Before Stress Test	\$81,584	\$401,213
2016- Post Stress Test	\$96,612	\$338,851
2017 - Pre PST increase	\$94,844	\$345,412
2017 - After PST increase	\$98,459	\$332,127
2018	\$102,767	\$317,725
2019	\$101,969	\$320,296

Based on the 2016 census median household income for the City of Regina

Figure 22 – Affordability by income group



Average price for sales between January to June 2019

Source: Calculations based on NAHB "Priced-Out" Methodology

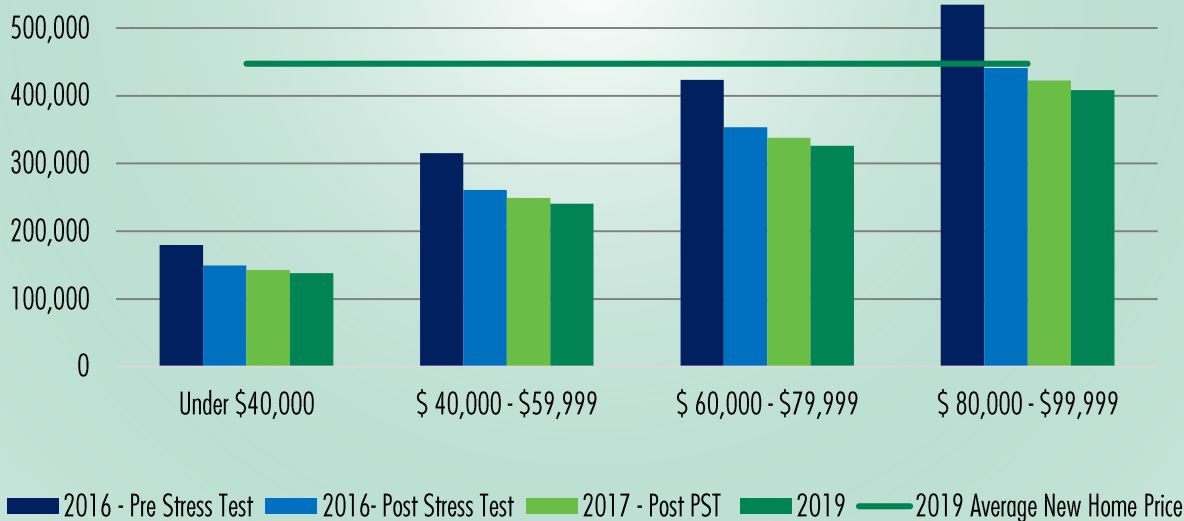
SASKATOON HOUSING AFFORDABILITY

Figure 23 - Impact on housing affordability as a result of policy changes

	Household income required to buy a \$400,000 pre-tax home	Maximum Post-tax home price affordability for the median household income
2016 - Before Stress Test	\$75,611	\$418,016
2016- Post Stress Test	\$90,639	\$348,960
2017 - Pre PST increase	\$91,164	\$346,865
2017 - After PST increase	\$94,631	\$333,524
2018	\$98,797	\$320,638
2019	\$97,914	\$323,458

Based on the 2016 census median household income for the City of Saskatoon

Figure 24 - Affordability by income group



Average price for sales between January to June 2019

Source: Calculations based on NAHB "Priced-Out" Methodology

2018 SASKATCHEWAN NEW HOME SALES BY PRICE AND PROPERTY TYPE



2,297 home sales

2,230 Sales with price



1,455 single family homes



183 semi-detached homes



351 row housing



308 apartment units

Table 4 – 2018 Saskatchewan new home sales

Price range	Single	Semi-Detached	Row	Apartment	Total
Under \$250,000	20	0	8	112	140
\$250,000-\$400,000	505	156	291	158	1,110
\$400,000-\$500,000	408	19	25	23	475
\$500,000-\$750,000	344	8	16	7	375
\$750,000+	122	0	0	8	130
Priced	1,399	183	340	308	2,230
Unpriced	56	0	11	0	67
Total	1,455	183	351	308	2,297

Source: Canada Mortgage and Housing Corporation

PST REBATE STRUCTURE ANALYSIS



The residential construction industry is operating below efficiency which in turn translates into a suboptimal provincial government's revenue collection through PST as well as income/payroll tax from the industry.



An analysis on three rebate scenarios to offset a portion of the PST increase on new home sales in Saskatchewan is presented in the following pages. The analysis does not take into consideration the change in the PST rate but only the change in rules. Additionally, the scenarios exclude the impact of additional taxation or economic activity in the province (i.e. payroll tax, corporate tax etc.).



While the rebate has an upfront cost to the Government of Saskatchewan in the form of forgone revenue, it is intended to stimulate the housing market and support companies in the residential construction sector, most of which are locally owned. This will give companies the ability to keep investing, maintain jobs and support overall economic growth throughout the province. Ultimately, the net impact will depend on the market response to lower price and also to other macroeconomic factors.

SCENARIO 1 – REBATE EQUAL TO THE INCREASE IN PST

The first scenario estimates a rebate which fully offsets the increase in PST on new housing construction. This is a reduction of 262 basis points to the PST rate and a decrease of 37.6% on the tax payable per home.

The PST collection from an additional 4,130 new home sales would fully fund the rebate cost and thus achieving revenue neutrality. This assumes that the new sales are also eligible for the rebate and that new sales follow the same price distribution as the 2018 transactions.

Table 5 – PST rebate amount

	Average Price	Units	Average Rebate	Value
Under \$250K	\$200,000	140	\$5,240	\$733,600
\$250K-\$400K	\$325,000	1,110	\$8,515	\$9,451,650
\$400K-\$500K	\$450,000	475	\$11,790	\$5,600,250
\$500K-\$750K	\$625,000	375	\$16,375	\$6,140,625
\$750K+	\$750,000*	130	\$19,650	\$2,554,500
Total		2,230		\$24,480,625

*minimum price

Table 6 – Additional sales for revenue neutrality

	Average Price	Taxes	Units	Rebate
Under \$250K	\$200,000	\$3,160	486	\$1,536,900
\$250K-\$400K	\$325,000	\$5,135	2,373	\$12,185,423
\$400K-\$500K	\$450,000	\$7,110	733	\$5,214,483
\$500K-\$750K	\$625,000	\$9,875	417	\$4,116,697
\$750K+	\$750,000*	\$11,850	120	\$1,427,122
Total			4,130	\$24,480,625

*minimum price

SCENARIO 2 - SLIDING SCALE “PHASE OUT”

The second scenario is a sliding scale “phase out” rebate. Similar to the GST rebate, this scenario proposes a full rebate to offset the PST increase (2.62%) for homes up to \$350,000. The rebate would progressively decrease and would be eliminated for homes valued over \$450,000.

Under this scenario, the estimated rebate on 2018 sales (2,230 homes with price) would have been \$9.7 million to the benefit of buyers of new homes. An additional 1,175 new home sales would be required to achieve revenue neutrality. It is important to note that the PST from higher priced homes will subsidize lower priced housing which is typically purchased by households with no equity, mainly firsttime buyers, new Canadians and vulnerable groups.

Table 7 – PST rebate amount

	Average Price	Units	Average Rebate	Estimate amount
Under \$250K	\$200,000	140	\$5,240	\$733,600
\$250K-\$400K	\$325,000	1,110	\$7,545	\$8,375,158
\$400K-\$500K	\$450,000	475	\$1,158	\$550,200
\$500K-\$750K	\$625,000	375	\$0	-
\$750K+	\$750,000*	130	\$0	-
Total		2,230		\$9,658,958

*minimum price

Table 8 – Additional sales for revenue neutrality

	Average Price	Taxes	Units	Rebate
Under \$250K	\$200,000	\$3,160	192	\$606,392
\$250K-\$400K	\$325,000	\$6,105	788	\$4,807,822
\$400K-\$500K	\$450,000	\$17,742	116	\$2,057,401
\$500K-\$750K	\$625,000	\$26,250	62	\$1,624,264
\$750K+	\$750,000*	\$31,500	18	\$563,078
Total			1,175	\$9,658,958

*minimum price

SCENARIO 3 - STAGGERED REBATE

The third scenario involves a staggered deduction with 1% PST rebate on the first \$350,000 of the new home price; and a 0.5% PST rebate on next portion of the sale price from \$350,001 to \$450,000. The rebate would apply to all sales regardless of the final sale price of the new home.

This scenario has the lowest cost of the three options presented in this paper with an estimated cost of \$8.3 million based on 2018 home sales. It also requires the least amount of additional sales, with only 637 transactions required to achieve revenue neutrality. Similar to the previous options, the rebate is funded based on the distribution of 2018 sales.

Table 9 – PST rebate amount

	Average Price	Units	Average Rebate	Estimate Amount
Under \$250K	\$200,000	140	\$2,000	\$280,000
\$250K-\$400K	\$325,000	1,110	\$3,250	\$3,607,500
\$400K-\$500K	\$450,000	475	\$4,000	\$1,900,000
\$500K-\$750K	\$625,000	375	\$4,000	\$1,500,000
\$750K+	\$750,000*	130	\$4,000	\$520,000
Total				\$7,807,500

*minimum price

Table 10 – Additional sales for revenue neutrality

	Average Price	Taxes	Units	Rebate
Under \$250K	\$200,000	\$6,400	77	\$490,157
\$250K-\$400K	\$325,000	\$10,400	374	\$3,886,244
\$400K-\$500K	\$450,000	\$14,900	112	\$1,663,033
\$500K-\$750K	\$625,000	\$22,250	59	\$1,312,920
\$750K+	\$750,000*	\$27,500	17	\$455,146
Total			637	\$ 7,807,500

*minimum price

ECONOMIC IMPACTS

Table 11 – PST rebate scenarios summary

	Scenario 1	Scenario 2	Scenario 3
Initial Costs	\$24,480,625	\$9,658,957.67	\$8,330,625.00
Rebate cost burden distribution			
Under \$250K	3%	8%	6%
\$250K-\$400K	39%	87%	50%
\$400K-\$500K	23%	6%	21%
\$500K-\$750K	25%	0%	17%
\$750K+	10%	0%	6%
Total	100%	100%	100%
Additional sales for revenue neutrality	4,130	1,175	637

The additional sales to achieve revenue neutrality under any scenario appear to be unachievable. However, the intent is to demonstrate the potential gains from a small increase in new home sales. This analysis does not estimate the potential economic impact from a specific rebate scenario.

In 2018 the average housing start investment in Saskatchewan was \$237,949.54. According to the latest figures from Statistics Canada, each housing start creates on average 1.5 jobs, generates \$84,000 in income and adds \$163,000 to GDP.

A 5% increase in housing starts represents an additional \$29.5 million in GDP, over 265 jobs and over \$15.3 million in income for Saskatchewan families. This far exceeds the costs from any of the rebate scenarios introduced in this analysis.

Simple multiplier represents the economic impact of housing construction with industries linked to the construction industry. Total multiplier also includes the induce effect. This represents the impact from household spending income earned in the construction industry through the full economy.

Table 12 – Economic impact per housing start

	Simple multiplier	Total multiplier
GDP	\$142,174.97	\$163,680.43
Taxes	\$6,212.69	\$6,451.64
Income	\$76,463.85	\$84,827.09
Jobs	1.3	1.5

Table 13 – Economic Impact for a 5% increase in housing starts

	Simple multiplier	Total multiplier
GDP	\$25,662,582.94	\$29,544,318.18
Taxes	\$1,121,390.18	\$1,164,520.57
Income	\$13,801,725.28	\$15,311,288.98
Jobs	229.7	265.0

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